Submission to the Ministerial Council on Energy Standing Committee of Officials

Application of the Industry Levy to fund the AER and AEMC

Response to Discussion Paper

April 2004

National Office
Level 3, 40 Blackall Street, Barton ACT 2600
Telephone: +61 2 6272 1555 Facsimile: +61 2 6272 1566
Email: info@ena.asn.au Website: www.ena.asn.au

Overview

The Energy Networks Association (ENA) opposes the implementation of an industry levy to fund the Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC).

The ENA understands that the Discussion Paper released by the Ministerial Council on Energy (MCE) Standing Committee of Officials is intended to discuss principles for developing cost recovery arrangements for the AER and the AEMC. The ENA considers, however, that the imposition of a levy would be inefficient, inequitable and unworkable given the proposed functions of these bodies as:

- the benefits of energy market regulation accrues to the wider community, not just the energy sector being levied;
- the proposed levy may create distortions in the energy market, an outcome which would be contrary to Council of Australian Government policies to promote the wider penetration of natural gas;
- many of the market development functions envisaged for the AEMC are difficult to allocate to particular industry sectors in an equitable manner and may have little application to energy distribution businesses at all;
- the AER and the AEMC lack accountability to industry with regard to both activities carried out and expenditure;
- the proposed functions of the AEMC are policy-related, with benefits accruing to the wider community;
- current experience with industry funded regulation is negative and has led to an adversarial and litigious relationship between the regulator and industry, as well as being characterised by increasing costs; and
- the proposed model is internationally untested and the cost recovery arrangements are radically different in scope to any comparable jurisdiction.

If full cost recovery arrangements were implemented despite these concerns, the ENA considers that:

- the total cost of regulation currently imposed in industry participants should fall, reflecting the intended efficiencies gained from streamlining energy regulation;
- imposing “start-up” costs on industry would be highly inappropriate, provide no incentives for efficiency and be impossible to allocate equitably;
- regulated energy network businesses should not pay for market operation and market regulation;
- regulated network businesses should not be expected to pay for access regulation. If costs are levied on regulated network businesses, network businesses require a guarantee that they can be passed through transparently and in full to consumers with a specific mechanism in the Code to enshrine this guarantee;
- the AEMC and AER expenditure must be accountable to the MCE and industry;

- the arrangements should recognise that not all activities of the AER and the AEMC can be recovered through an industry levy; and
- adequate transitional arrangements must be in place which recognises the considerable obligations currently imposed on network businesses by jurisdictional regulators.

Background

This submission responds to the *Discussion Paper – Application of the Industry Levy to fund the AER and AEMC* (the Discussion Paper) circulated for comment by the Ministerial Council on Energy Standing Committee of Officials on 12 March 2004.

The Energy Networks Association is the newly established national representative body for gas and electricity distribution network businesses. Energy network businesses deliver electricity and gas to over 12 million customer connections across Australia through approximately 800 000 kilometres of electricity lines and 75 000 kilometres of gas distribution pipelines. These distribution networks are valued at more than $28 billion, and each year energy network businesses undertake capital investment of more than $2 billion in network reinforcement, expansions and greenfield extensions.

At its 11 December 2003 meeting, the Ministerial Council on Energy (MCE) agreed to fund the AER and the AEMC through an industry levy. This decision was made without industry consultation, although governments have since undertaken to consult on the development of the levy arrangements.

The Discussion Paper released on 22 March 2004 canvasses options for cost recovery for the AER and the AEMC. The ENA considers that the Discussion Paper is deficient in a number of respects, including:

- a lack of analysis of the policy case for cost recovery for these bodies;
- the failure to differentiate between the roles and functions of the AER and the AEMC;
- the focus on efficient points of taxation, rather than the appropriate allocation of costs and benefits to industry sectors and individual businesses;
- the punitive focus on cost recovery as a penalty for regulated businesses;
- the suggestion that the resort to legal avenues by industry participants is irresponsible, despite the fact that the Courts have ruled in favour of industry participants in almost every case; and
- the inconsistency in the canvassed options with the *Commonwealth Guidelines for Cost Recovery for Regulatory Agencies.*

Policy rationale for industry funding

The Discussion Paper states that the objectives for the funding mechanism include economic efficiency, competitive neutrality, equity, transparency and incentives for the responsible behaviour by energy sector participants. The ENA considers that an industry levy delivered by any of the proposed mechanisms in the Discussion Paper is unlikely to achieve these objectives.

The most efficient, equitable, transparent and simple mechanism to pay for the AER and AEMC would be through consolidated revenue, an option not canvassed in the Discussion Paper.

The ENA urges the MCE to reconsider the decision to fund the energy market institutions through an industry levy, as the proposal undermines current energy market reforms which seek to increase efficiency in the energy market.

The following sections outline why the imposition of an industry levy will not achieve the objectives stated in the Discussion Paper by addressing each of the objectives in turn. Some the arguments raised are relevant for multiple objectives and have been repeated for this reason.

Economic Efficiency

The ENA is concerned that the *Commonwealth Cost Recovery Guidelines for Regulatory Agencies* do not appear to have been considered in developing the case for cost recovery for the AER and the AEMC.[1] The *Guidelines* recognise that there are many situations where cost recovery for regulatory agencies is inappropriate, particularly where arrangements are complex and suffer from free-rider inefficiencies.

Funding the AER and the AEMC through an industry levy (or other forms mentioned in the Discussion Paper) will inappropriately impose regulatory and market development costs on parties where the benefits of regulation and market development accrues to the wider community. This would be an inefficient outcome leading to significant free-rider problems, inequality in distributing costs between and across sectors, and distortions in competitive energy market outcomes.

Beneficiaries of Regulation

The principle underlying allocationary rationale for cost recovery in the Discussion Paper appears to be "user" and/or "causer pays".[2] This approach assumes that regulation is either sought, and is therefore a benefit that should be paid for, or a penalty, that is deservedly charged on a market participant. This principle does not apply, however, for a significant proportion of existing regulation in the energy sector.

The ENA differentiates between energy *market* regulation and energy *access* regulation. Energy *market* regulation involves monitoring industry compliance with market rules set out in the National Electricity Code. There is no current equivalent in the national gas market. Energy *access* regulation involves functions required under Part IIIA of the *Trade Practices Act 1974* for both gas and electricity. The proposed institutional arrangements for the AER transfer both energy market regulation and energy access regulation to the AER. The ENA considers that the issues arising from market and access regulation are different and this difference should influence any decision to recover the full costs of the regulator from industry participants.

[1] Australian Government Department of Finance and Administration (2002) *Commonwealth Cost Recovery Guidelines for Regulatory Agencies* http://www.finance.gov.au/finframework/docs/Guidelines_-_Regulatory_2_Dec.pdf

[2] Ministerial Council on Energy Standing Committee of Officials, *Application of the Industry Levy to fund the AER and AEMC – Discussion Paper* (March 2004) p.6

Recovery of the costs of market regulation appears to be most appropriate where market regulation bestows a benefit on market participants, in that market participants derive an advantage both from the existence of the market structure, and from its effective policing which reduces the risks of operating in that market (through prudential requirements and the like).

The same arguments do not apply in the case of energy access regulation. Access regulation is intended to provide access to monopoly infrastructure to promote competition in an upstream or downstream market. While the benefits of access regulation accrue to related markets, energy users and the community in general through the provision of non-discriminatory open access, the costs of that regulation are borne by network service providers and end users.

Some industry beneficiaries of access regulation can be easily identified, such as holders of energy retail licences, however, other beneficiaries of access regulation, such as upstream producers and large users that do not contract with retail licensees may be less easily determined.[3] Further, non-scheduled electricity generators are usually linked to the distribution network, yet do not pay licence charges or participant fees. These generators do, however, benefit from network regulation. Distributed Network Service Providers (DNSPs), as recognised in the NEMMCO decision on cost recovery for NEMMCO and NECA, are passive players in the electricity market and should not be levied.[4]

A principle that relies on "causer pays" principles where regulated assets pay the costs of that regulation appears to unfairly penalise network service providers for operating infrastructure that exhibits natural monopoly characteristics. The decision to privatise some natural monopoly infrastructure was made by governments. The identification and regulation of these assets is not as a result of particular behaviours by businesses operating natural monopoly assets, and as such should not elicit punishment through charges.

While a levy paid by generation and/or retail licence holders, would be more appropriate than charging a regulated network for its own regulation as it would target the beneficiaries of regulation, this would suffer from significant free-rider inefficiencies. As mentioned earlier, in addition to the levied industry beneficiaries, the community as a whole benefits from the regulation.

It is important to remember that the cost of regulation is considerable. The ENA estimates that the current annual costs of energy market regulation borne by regulatory institutions are in the vicinity of $43.1m, with only $4.1m of this money funding NECA. A significant proportion of the remaining $39m can be attributed to access regulation. Another study conducted by ACIL Tasman consultants suggests that the cost of administering electricity and natural gas regulation exceeds $100 million per annum.[5]

---

[3] The Australian Petroleum Production and Exploration Association identified gas producers as a major beneficiary of access regulation in its 9/3/04 submission to the Productivity Commission Review of the Gas Access Regime. see http://www.pc.gov.au/inquiry/gas/subs/sublist.html

[4] NEMMCO *Determination of the Structure of Participant Fees Under Clause 2.11 of the National Electricity Code* (26 March 2003). p. 41

[5] Morris, Nick, ACIL Tasman Chief Executive, speech to the Victoria Power Conference February 2004, reported in the *Energy Supply Association of Australia News* (1 March 2004).

If even a small proportion of these costs are imposed on the energy sector via a levy (and in addition to the proposal to also fund the AEMC via industry levy), the potential impact on energy infrastructure and energy intensive industries would be considerable, and could potentially affect exports of energy intensive goods. This fact further emphasises the significant economy-wide free-rider problem of energy access regulation, where the economy as a whole benefits from energy access regulation.

The ENA argues that access regulation, therefore, is more appropriately funded through general taxation revenue. This approach would also be more in line with the *Commonwealth Cost Recovery Guidelines*.

Beneficiaries of Market Development

The Discussion Paper envisages a mechanism for charging parties for direct costs arising from market development. It is difficult to imagine an approach of this kind that does not give rise to free-rider problems, particularly in the case of substantial code changes and market reviews.

Substantial code changes are likely to focus on a particular sector of the market, but also require consideration of the affects of that change on all sectors. This would involve assessment of the competitive and regulatory settings of the market to determine how a particular change is likely to affect each sector.

Options for charging include charging the code change instigator for the full costs of considering and implementing a code change, charging the sector that "benefits" from the code change, or treating the cost as a common cost and charging at the most efficient point of taxation. The ENA argues that each of these options give rise to inefficiencies.

Charging the code change instigator would mean that all other market facing businesses would free-ride on that code change. The *Commonwealth Cost Recovery Guidelines* suggest that this approach is not appropriate of this reason.[6] It may be possible to charge the industry sector that benefits from that code change, but this may not be easy to identify and may cause considerable conflict, both by exacerbating perceived and actual inequalities in the market, as well the process creating inequality issues. For instance, the NEMMCO Determination for Participant Fees recognises that while some of its activities may relate to transmission and distribution businesses, these businesses are passive in the market and therefore should not be charged.[7] The allocation of costs to beneficiaries or "causers" of regulation is likely to be even more difficult where work is directed by the MCE, such as for market reviews.

The alternative approach may be to treat these kinds of costs as common, and levy them at the most efficient point of taxation. The Discussion Paper suggests that one of these points may be the regulated wire and pipe industries. This suggestion, however, does not recognise that that these businesses may not be able to pass through costs as increasing costs can adversely affect demand. This outcome would create a significant

[6] Australian Government Department of Finance and Administration (2002), p. 16
[7] NEMMCO (26 March 2003)., p. 41

inefficiency in the market where the costs of the market bodies can not be fully passed on to energy users. This issue will be considered further in the next section.

Competitive Neutrality

The ENA considers that a levy system that allocates costs to regulated electricity and gas businesses may distort investment decisions between electricity and gas infrastructure. This is the case as, even with consistent regulatory treatment and pass-through of the costs of regulation in the electricity and gas distribution sectors, the effect of this pass through is likely to be different for each sector as the demand for gas is generally more discretionary than that for electricity, particularly where gas is used as a fuel for electricity generation or for products destined for export. This higher price elasticity of demand means that the ability of the gas sector to recoup the costs of regulation through tariffs will be affected as those increasing tariffs adversely affect demand. This would be an inefficient outcome arising from the regulatory treatment of the energy sector.

Other stated Council of Australian Governments policy goals such as encouraging the wider penetration and uptake of natural gas would also be at risk under this approach for the same reasons.[8]

Equity

The proposed functions of the AEMC, including general market rule development, reviews and planning, are likely to impact on all industry sectors, making a meaningful split of the costs of that institution between industry participants impossible to implement on an equitable basis.

The cost of energy market regulation has already been shown to be considerable, with diffuse beneficiaries of that regulation. The possible costs associated with the new market development function are, however, altogether unknown. While some of the proposed functions of the AEMC are already undertaken by NECA, NEMMCO or the National Gas Pipelines Advisory Committee, others are new. In addition to this, they are subject to addition by Ministerial direction, such as through directions to undertake reviews. This means that businesses will suffer from a considerable quantum risk related to the range of possible costs that may be included in any industry levy.

This problem is further compounded by the variability in the number of assets that will be subject to AER regulation and the rules developed by the AEMC, and the allocation of the costs of those activities between businesses. As the gas market develops, and as the recommendations of the Productivity Commission reviews of the National and Gas Access Regimes are implemented, a greater proportion of distribution networks and pipelines can be expected to become unregulated or be covered by a monitoring or lighter-handed regime.[9] Similar developments and pressures may well be felt in the electricity sector over time. The costs of these and other possible models are as yet unknown.

[8] Council of Australian Governments, Energy Policy Outcomes, 8 June 2001.
[9] Productivity Commission *Review of the Gas Access Regime – Draft Report*, December 2003, p. 175.

Indeed, some disagreement already exists over the likely costs of imposing a price monitoring regime. While the Productivity Commission proposal suggests that a monitoring regime would be less costly to administer, given that the data provided to the regulator and the need to analyse that data under this regime would be considerably reduced, the ACCC argued in its submission to the Review that a monitoring regime is likely to require the same level of resources as the current regime.[10]

Any industry levy arrangements would need to be able to equitably accommodate proposed changes in the regulatory and coverage status of energy networks, as well as take into account the relative costs of the different types of regime envisaged, for example, for the gas access regime. Depending on who is to be believed about the costs of applying a monitoring regime, the relevant charges levied on an asset regulated under a monitoring regime, *vis a vis* an asset under a full price regulation regime needs to be considered.

The changing regulatory status of networks is likely to be an even greater problem if networks are used as a point of levying for common costs for the AER and the AEMC. The assumption in the Discussion Paper that these assets are permanently regulated is inaccurate, and runs contrary to the policy intent of third party access regulation and the *Trade Practices Act*. The changing regulatory status of network assets will change the cost recovery burden on other energy network businesses.

If regulated network businesses are to be used as a collection point for common costs, then an additional problem is likely to arise where these costs are not collected for delivery chains where the distribution asset is not regulated, or where energy users are directly connected to the transmission asset. These situations are likely to lead to perverse outcomes where the common costs of market institutions are not paid by all end users and the burden is weighted on small users connected to the distribution network. Further, with regard to regulation of distribution assets, this approach could create an incentive to retain regulation on assets where it is not otherwise justified due to the competitive settings of the market.

In this changing regulatory environment, the allocation of the costs of regulation and market development is likely to become increasingly complicated and unpredictable, and the costs very difficult to predict in advance, and create distortions between the electricity and gas markets.

Given these facts, and the high degree of correlation between energy users and tax payers, a more efficient and distributive approach would be to fund these agencies through general taxation revenue. This approach would also be in line the *Commonwealth Cost Recovery Guidelines*, which states that levies and fees should not be charged where it is difficult to link the services to particular firms or identifiable groups.[11]

[10] Productivity Commission (December 2003), pp. 268 and 264.
[11] Australian Government Department of Finance and Administration (2002) p. 19

Accountability and transparency

The ENA has considerable concerns over the accountability of the AER and the AEMC, particularly in relation to the policy role of the AEMC and current experience with industry funded regulators in Australia.

Policy functions of the AEMC

The AEMC has been described as a market development body, yet its structure and operation more closely resembles that of a policy body. The AEMC has been structured as a commission, with ultimate accountability of Members to the MCE. The MCE also has a power of direction over the AEMC and industry is not involved in the appointment of Members. Industry involvement has been reduced to a consultative role, with decisions ultimately taken by the AEMC Members. Given this structure, it is difficult to view this body as anything other than a government policy body.

To justify funding this body through an industry levy, indeed for this body to be a true market body, the AEMC would need far stronger consultation with and accountability to industry, with Members appointed with reference to industry preferences.[12] Given these issues, it would appear more appropriate that the AEMC be funded via general taxation revenue, rather than an industry levy, recognising the underlying policy nature of this body.

Deficiencies of current industry funding approaches

Currently, the only Australian jurisdiction that recovers the full cost of energy access regulation through industry charges is the Western Australian Economic Regulation Authority (ERA), formerly OffGAR. While other jurisdictions do have some cost recovery through licence fees or similar arrangements, the ERA is entirely underwritten by fees levied on industry participants. Problems have been raised over the appropriateness of these arrangements and the accountability of the regulator in a number of forums, and were recognised in the Productivity Commission *Review of the Gas Access Regime* Draft Report.

The Productivity Commission found that “the funding regulations in Western Australia might change the incentives facing the regulator”, and may “create incentives that run counter to agency efficiency and encourage undesirable practices”.[13] These concerns arise from the lack of accountability of the regulator to budgetary and parliamentary processes, brought about by the ability of the regulator to bill pipelines for costs incurred in the regulation of them. The cost of regulation on industry has proved to be high, variable, and escalating under this arrangement.[14]

---

[12] The features that would be required for the AEMC to be considered an accountable market development body appropriate to be funded by an industry based levy are discussed in detail on pp. 13-14.

[13] Productivity Commission (December 2003), p. 363

[14] OffGAR determines its performance with reference to the costs incurred to assess and oversee the regulation of a “standard” $500 million pipeline. OffGAR’s 2002/03 Annual Report estimates that it’s costs for assessing and overseeing a standard pipeline have increased from $611 000 in 2001/02 to $1.22m in 2002/03. OffGAR *Annual Report* 2002/03 http://www.offgar.wa.gov.au/library/RegulatorReport2003.pdf

While in other jurisdictions regulators have allowed the costs of regulation (including licence fees) to be passed through to the consumer, the West Australian regulator has not always allowed businesses to recover the full cost of regulation levied on them. This approach introduces significant regulatory risk for West Australian businesses not experienced by businesses operating in other jurisdictions.

Further, problems of accountability in costs and billing arrangements and restrictions on cost pass through between the regulator and West Australian pipelines has led to ongoing and costly litigation and a polarised and adversarial relationship between the regulator and service providers. This situation is not conducive to effective regulation and information flow between service providers and the regulator and runs contrary to the aims of the West Australian regulator to facilitate the effective and efficient regulation of access to gas pipelines at the lowest practicable regulatory cost.[15]

International Experience

The proposal to fund the AER and the AEMC through a true industry levy is internationally untested. The ENA has found no international examples of energy regulators or market developers being funded through an industry levy of the types outlined in the Discussion Paper. In the United States, the Federal Energy Regulatory Commission (FERC) operates within an annual government appropriation, which is redeemed throughout the year through licences and fees for service. In the United Kingdom, the Office of Gas and Electricity Markets, (Ofgem) is funded through licensing and other fees. Both of these arrangements impose up-front boundaries on the operating costs of these agencies. They also represent a clearer "fee for service" structure than a broad industry levy.

Placing the market development function in a dedicated agency is a uniquely Australian proposal and, as such, it is not possible to turn to international examples of funding for this type of body. The risk in this is therefore high, as there are no comparable bodies available to give an indication of the potential costs or problems that may be faced by a market development agency. The funding proposal inappropriately transfers these risks from government to industry.

Industry Funding – Issues and Principles if Pursued

The ENA considers that there are strong arguments for the AEMC and the access regulation functions of the AER not to be funded through an industry levy. Despite these arguments, the ENA is also including in this submission issues and principles that should govern an industry funding regime if governments persist in having one introduced. This inclusion should not be seen as an acceptance of an industry funding regime should it reflect these characteristics. The ENA considers funding the energy market institution through an industry levy to be a considerably inferior option to funding through general taxation revenue.

[15] Western Australia Economic Regulation Authority Mission Statement http://www.offgar.wa.gov.au/mission.htm access 11/3/04

If the industry funding proposal is to proceed, it is important for the AER and AEMC funding arrangements to be consistent with the *Commonwealth Cost Recovery Guidelines*. Basic principles outlined in the *Guidelines* require cost recovery frameworks to be cost effective, consistent with policy objectives and not to stifle competition and industry innovation.[16] Importantly, the *Guidelines* recognise that not all activities of a regulatory agency are suitable for cost recovery, and that those that are funded in that way need to be cost effective, efficient, consistent with policy goals, and not impose incentives on regulated businesses that are contrary to the goals of the regulation.[17] It would appear that there are at least some intended activities of the AER and AEMC that would not satisfy these requirements, meaning that at least part of the AER and AEMC budgets must be derived from general taxation revenue. Examples of these activities include legal actions and Ministerial servicing.

Further, given the intention that the new arrangements streamline regulation and reduce the number of regulators operating in the market, it is appropriate to expect an industry levy to deliver a total reduction of regulatory costs currently incurred by market participants.

Start-up costs

The Discussion Paper raises the possibility of start-up costs being included in industry levy arrangements. The ENA considers that this proposal is highly inappropriate as it:

- imposes costs on industry of which it has had and will not have control or input into;
- is *post hoc* and therefore not included in industry forward cost planning; and
- establishes poor incentives to ensure establishment decisions made by governments reflect efficient and least cost practices (akin to those constraints imposed on regulated businesses).

Including start-up costs in the cost recovery arrangements gives industry no means to determine whether money is expended appropriately, whether it is allocated equitably, or even the quantum of those costs. Additionally, it is difficult to see how these costs could be allocated equitably between levied energy industry sectors, and between firms within particular parts of the energy delivery chains or located along these chains.

This is particularly the case considering the staged transfer of functions to the AER and the AEMC, with distribution only being subject to the new institutional arrangements from 2006, if at all. It would be inappropriate to allocate all of the start-up costs of these agencies to the initial industry sectors covered by them. Equally, the alternative option to charge industry sectors for start-up costs of an agency which does not yet (and may never) apply to them is also inappropriate. Additionally, this second option runs the risk of dual costs being imposed on industry participants which may already be paying state based regulatory charges through licence fees.

[16] Australian Government Department of Finance and Administration (2002) p.5
[17] Australian Government Department of Finance and Administration (2002) pp..15 and 20.

Energy market operation and regulation costs

The arrangements for industry funding of market operation and market rule compliance (market regulation), as distinct from access regulatory or policy functions, have recently been settled. The funding formula was developed after industry consultation and an investigation into activities of NEMMCO and NECA, including a breakdown of the costs of service for these activities.

In its determination, NEMMCO identified that the beneficiaries of market management and regulation were market generators, market network service providers and market customers, on the basis that they use the trading mechanisms to balance supply and demand. Regulated Transmission and Distribution Network Service Providers were considered to be passive in that process, existing to facilitate the physical operation of the market, and therefore not levied.

As outlined earlier, ENA considers that there are stronger arguments to recover the costs of market operation and market regulation through industry charges than there is to fund energy access regulation through an industry levy. Given that funding arrangements for the market activities of NECA and NEMMCO are currently in place, it may be appropriate for these funding arrangements to continue until the determination expiry date of 30 June 2006. Following this period, ENA electricity distribution members should not be expected to pay for the operation of the AER market regulation functions or be held liable under any changes to the NEMMCO role and levy structure.

Energy access regulation and AEMC costs

In line with NEMMCO and NECA arrangements, funding obligations should be linked to those that derive benefit from that regulation. In the case of access regulation, the benefits of that regulation accrue to the dependent market and its participants, not the regulated network itself. The costs of that regulation should then be charged to beneficiaries in dependent markets.

Failing this approach, if network service providers are to be expected to pay for access regulation, these costs at the very least need be able to be "passed through" to consumers through a guaranteed and agreed mechanism that binds regulatory discretion on the issue.

The MCE Report to CoAG on the Reform of Energy Markets recognises the need to encourage efficient market outcomes and growing convergence between the electricity and gas sectors. Regulatory treatments and provisions for the pass through of regulatory costs therefore need to be consistent across the electricity and gas sectors to ensure that regulation does not distort commercial decision making or fall inequitably across sectors.

The cost of a levy to fund the AER and AEMC is likely to be considerable, and if it is not included in the allowable operating expenditure of regulated businesses, has the potential to undermine regulated returns and the ability of network service providers to recover the reasonable costs of providing distribution services. Electricity price and revenue determinations, as well as gas access arrangement decisions, generally allow

the cost of complying with existing access regulation to be included in the allowable operating costs of the business and allowance for the pass through of variations in statutory charges and taxation are some of the most common and uncontroversial forms of pass through across regulated utilities worldwide. In the Australian market, these are returned to network businesses through TUOS and DUOS charges or regulated tariffs for electricity and gas respectively.

Any decision to levy the energy distribution sector needs to come with a guarantee that additional levy costs will be included in the allowable operating costs of businesses as incurred. These pass through costs should include both forecast expenditure as well as a capacity for early recovery of unanticipated costs arising from regulatory activities. These measures would act as a form of discipline to ensure these costs are accountable to the market in a timely manner.

A further issue arises from the discussion of network businesses in the Discussion Paper. The Discussion Paper appears to assume that network assets are perpetually subject to regulation. This assumption is clearly incorrect, as agreed changes to the National Access Regime are implemented and the criteria for regulation are strengthened and more networks are likely to become unregulated.[18] Indeed, the gas transmission and distribution sectors currently include a mix of regulated and unregulated assets.

This assumption of regulation in the network sector means that the prospect of unregulated businesses in an energy supply chain has not been considered. If regulated assets are used as the point of cost recovery for the energy industry, this would open the possibility that in some regions serviced by unregulated assets, the delivered price of energy will not include the costs of energy market regulation and development.

Accountability

If the energy industry is to pay for the operations and activities of the AER and the AEMC, then these bodies should be accountable to that industry in some way, most appropriately in the appointment of Members and the approval of budgets. ENA considers that it would be appropriate that at least one AEMC Member be nominated and appointed by the energy industry. In addition, an ultimate power of direction from the MCE to the AEMC is inconsistent with sound governance practices for a body which would be supported by an industry levy.

To ensure that charges levied on energy businesses are predictable, the AER and AEMC must work within a defined budget and additional funding sought by these bodies outside of normal funding cycles should not be imposed on industry. While both bodies should ultimately be accountable to the MCE for budgets, the additional measure of an industry appointed AEMC Member will provide a direct link between the proposed functions of the AEMC as a market development body, as the businesses that fund the body.

---

[18] Costello, Peter *Government Response to the Productivity Commission Report on the Review of the National Access Regime* (20 February 2004).

Some activities will not be billable

Governments should recognise that the AER and AEMC will require some public funding. The *Commonwealth Cost Recovery Guidelines* recognise that most regulatory agencies undertake a range of activities, some of which are not appropriately recovered through cost recovery measures. Examples of these types of functions include the costs of legal proceedings and consultancy fees to support legal proceedings.

Transitional arrangements

Many industry participants currently pay jurisdictional license and regulatory charges that may span several years. There should be no overlap in these arrangements where a network operator is required to pay both a state and national regulator to operate its business, particularly where distribution will not be covered by these two new institutions until at least 2006.

The Energy Networks Association
7 April 2004